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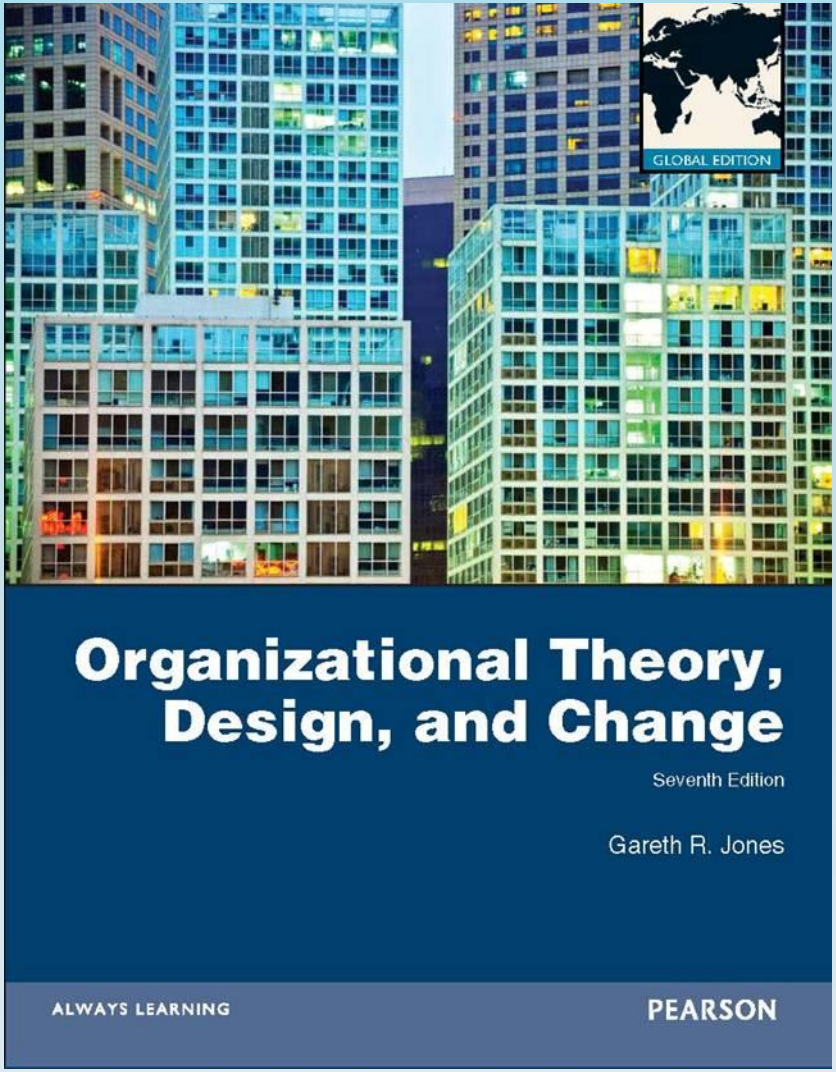


Stakeholders, Managers, and Ethics

Learning Objectives

- Identify the various stakeholder groups and their interests or claims on an organization
- Understand the choices and problems inherent in distributing the value an organization creates
- Appreciate who has authority and responsibility at the top of an organization, and distinguish between different levels of management

Learning Objectives

- Describe the agency problem that exists in all authority relationships and the various mechanisms, such as the board of directors and stock options, which can be used to help control illegal and unethical managerial behavior
- Discuss the vital role that ethics plays in constraining managers and employees to pursue the goals that lead to long-run organizational effectiveness

Organizational Stakeholders

- Stakeholders: People who have an interest, claim, or stake in an organization, in what it does, and in how well it performs
- Inducements: Rewards such as money, power, and organizational status
- Contributions: The skills, knowledge, and expertise that organizations require of their members during task performance

Table 2.1 – Inducements and Contributions of Organizational Stakeholders

Stakeholder	Contribution to the Organization	Inducement to Contribute
Inside		
Shareholders	Money and capital	Dividends and stock appreciation
Managers	Skills and expertise	Salaries, bonuses, status, and power
Workforce	Skills and expertise	Wages, bonuses, stable employment, and promotion
Outside		
Customers	Revenue from purchase of goods and services	Quality and price of goods and services
Suppliers	High-quality inputs	Revenue from purchase of inputs
Government	Rules governing good business practice	Fair and free competition
Unions	Free and fair collective bargaining	Equitable share of inducements
Community	Social and economic infrastructure	Revenue, taxes, and employment
General public	Customer loyalty and reputation	National pride

Organizational Effectiveness: Satisfying Stakeholders' Goals and Interests

- An organization is used simultaneously by various stakeholders to achieve their goals
- Each stakeholder group is motivated to contribute to the organization
- Each group evaluates the effectiveness of the organization by judging how well it meets the group's specific goals

Organizational Effectiveness: Satisfying Stakeholders' Goals and Interests (cont.)

- Evaluation of the organization
  - Shareholders – Return on their investment
  - Customers – Product reliability and product value relative to their price
  - Managers/Employees – Compensation, working conditions, career prospects

Organizational Effectiveness: Satisfying Stakeholders’ Goals and Interests (cont.)

- To be effective, an organization must at least minimally satisfy the interests of all the groups that have a stake in the organization
- Problems that an organization faces as it tries to win stakeholders’ approval
  - Choosing which stakeholder goals to satisfy
  - Deciding how to allocate organizational rewards to different stakeholder groups
  - Balancing short-term and long-term goals

Competing Goals

- Organizations exist to satisfy stakeholders' goals
- But which stakeholder group's goal is most important?
- In the U.S., the shareholders who are the owners of an organization's accumulated wealth/capital have first claim in the value created by the organization

Allocating Rewards

- Managers must decide how to allocate inducements to provide at least minimal satisfaction of the various stakeholder groups
- Managers must also determine how to distribute “extra” rewards
- Inducements offered to shareholders affect their motivation to contribute to the organization

Top Managers and Organizational Authority

- Authority: The power to hold people accountable for their actions and to make decisions concerning the use of organizational resources
- Shareholders
  - The stakeholder group with ultimate authority over the use of a corporation’s resources
  - Legally – They own the company
  - They exercise control over it through their representatives

Top Managers and Organizational Authority (cont.)

- The board of directors – Monitors corporate managers' activities and rewards corporate managers who pursue activities that satisfy stakeholder goals
  - Inside directors – Hold offices in a company's formal hierarchy
  - Outside directors – Not full-time employees

Top Managers and Organizational Authority (cont.)

- Corporate-level management – The inside stakeholder group that has the ultimate responsibility for setting company goals and objectives, for allocating organizational resources to achieve objectives, and for designing the organization's structure

Top Managers and Organizational Authority (cont.)

- Chain of command: The system of hierarchical reporting relationships in an organization
- Hierarchy: A classification of people according to authority and rank

The CEO's Role in Influencing Organizational Effectiveness

- Responsible for setting organizational goals and designing its structure
- Selects key executives to occupy the topmost levels of the managerial hierarchy
- Determines top management's rewards and incentives

The CEO's Role in Influencing Organizational Effectiveness (cont.)

- Controls the allocation of scarce resources such as money and decision-making power among the organization's functional areas or business divisions
- The CEO's actions and reputation have a major impact on inside and outside stakeholders' views of the organization and affect the organization's ability to attract resources from its environment

The Top-Management Team

- COO
  - Reports directly to the CEO – together they share the principal responsibility for managing the business
- Exec. Vice Presidents—Oversees and manages the company's most significant line and staff roles

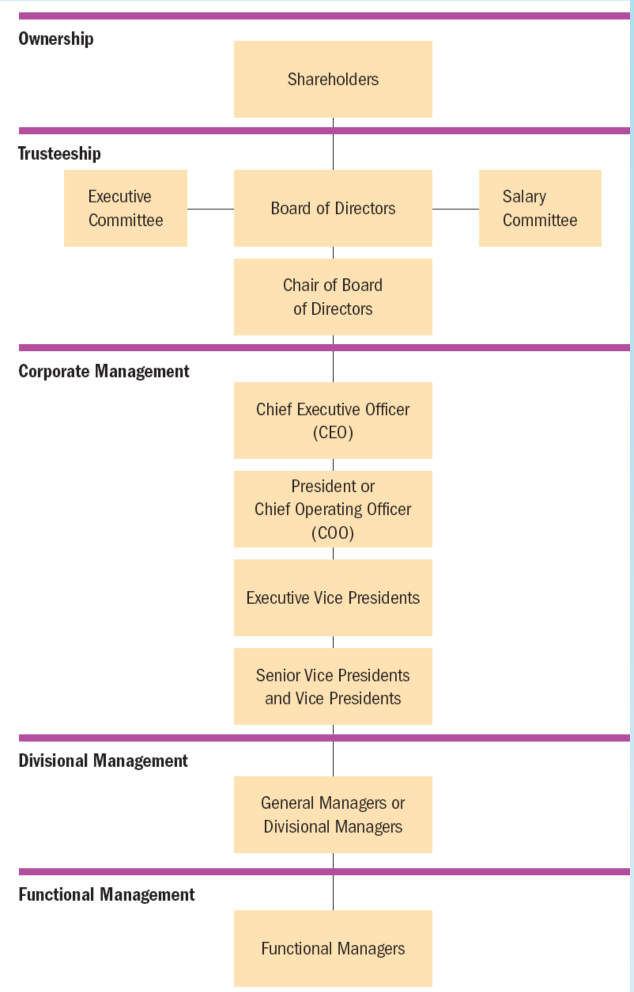
The Top-Management Team

Line-role	• Managers who have direct responsibility for the production of goods and services
Staff-role	• Managers who are in charge of a specific organizational function such as sales or research and development (R&D)
Top-management team	• A group of managers who report to the CEO and COO and help the CEO set the company's strategy and its long-term goals and objectives
Corporate managers	• The members of top-management team whose responsibility is to set strategy for the corporation as a whole

Other Managers

- Divisional managers: Managers who set policy only for the division they head
- Functional managers: Managers who are responsible for developing the functional skills and capabilities that collectively provide the core competences that give the organization its competitive advantage

Figure 2.1 – The Top-Management Hierarchy



An Agency Theory Perspective

- Agency theory offers a useful way of understanding the complex authority relationship between top management and the board of directors
- Agency relation arises when one person (the principle, i.e. shareholders) delegates decision-making authority/control over resources to another (the agent, i.e. managers)

Agency Problem

- A problem in determining managerial accountability that arises when delegating authority to managers
- Shareholders/principals are at an information disadvantage compared with top managers
- It takes considerable time to see the effectiveness of decisions managers may make

The Moral Hazard Problem

- It exists when:
  - A principal finds it very difficult to evaluate how well the agent has performed because the agent possesses an information advantage
  - The agent has an incentive to pursue goals and objectives that are different from the principal's

Solving the Agency Problem

- In agency theory, the central issue is to overcome the agency problem by using governance mechanisms that align the interests of principles and agents
- Governance mechanisms: The forms of control that align the interests of principal and agent so both parties have the incentive to work together to maximize organizational effectiveness

Solving the Agency Problem (cont.)

- The most effective way of aligning interests between management and shareholders is to make managers' rewards contingent on the outcomes of their decisions
- Ways of doing this:
  - **Stock-based compensation schemes**: Monetary rewards in the form of stocks or stock options that are linked to the company's performance
  - Promotion tournaments and career paths

Top Managers and Organizational Ethics

- Ethical dilemma: The quandary people experience when they must decide whether or not they should act in a way that benefits someone else, even if it harms others and isn’t in their own interest
- Ethics: moral principles or beliefs about what is right or wrong

Ethics and the Law

- Laws specify what people and organizations can and cannot do
- Laws specify sanctions/punishments when laws are broken
- Ethics and laws are relative
  - No absolute or unvarying standards exist to determine how people should behave

Ethics and Organizational Stakeholders

- Ethics help managers decide how best to respond to the interests of various organizational stakeholders
- A decision is probably acceptable on ethical grounds if a manager can answer "yes" to each of these questions:
  - Does my decision fall within the accepted values or standards that typically apply in the organizational environment?

Ethics and Organizational Stakeholders (cont.)

- Am I willing to see the decision communicated to all stakeholders affected by it?
- Would the people with whom I have a significant personal relationship approve of the decision?

Table 2.2 – Utilitarian, Moral Rights, and Justice Models of Ethics

Utilitarian model. An ethical decision is one that produces the greatest good for the greatest number of people.

Managerial implications. Managers should compare and contrast alternative courses of action based on the benefits and costs of these alternatives for different organizational stakeholder groups. They should choose the course of action that provides the most benefits to stakeholders. For example, managers should locate a new manufacturing plant at the place that will most benefit its stakeholders.

Problems for managers. How do managers decide on the relative importance of each stakeholder group? How are managers to measure precisely the benefits and harms to each stakeholder group? For example, how do managers choose among the interests of stockholders, workers, and customers?

Moral rights model. An ethical decision is a decision that best maintains and protects the fundamental rights and privileges of the people affected by it. For example, ethical decisions protect people's rights to freedom, life and safety, privacy, free speech, and freedom of conscience.

Managerial implications. Managers should compare and contrast alternative courses of action based on the effect of these alternatives on stakeholders' rights. They should choose the course of action that best protects stakeholders' rights. For example, decisions that would involve significant harm to the safety or health of employees or customers are unethical.

Problems for managers. If a decision will protect the rights of some stakeholders and hurt the rights of others, how do managers choose which stakeholder rights to protect? For example, in deciding whether it is ethical to snoop on an employee, does an employee's right to privacy outweigh an organization's right to protect its property or the safety of other employees?

Justice model. An ethical decision is a decision that distributes benefits and harms among stakeholders in a fair, equitable, or impartial way.

Managerial implications. Managers should compare and contrast alternative courses of action based on the degree to which the action will promote a fair distribution of outcomes. For example, employees who are similar in their level of skill, performance, or responsibility should receive the same kind of pay. The allocation of outcomes should not be based on arbitrary differences such as gender, race, or religion.

Problems for managers. Managers must learn not to discriminate against people because of observable differences in their appearance or behavior. Managers must also learn how to use fair procedures to determine how to distribute outcomes to organizational members. For example, managers must not give people they like bigger raises than they give to people they do not like or bend the rules to help their favorites.

Sources of Organizational Ethics

Societal ethics	• Codified in a society's legal system, in its customs and practices, and in the unwritten norms and values that people use to interact with each other
Professional ethics	• The moral rules and values that a group of people uses to control the way they perform a task or use resources
Individual ethics	• The personal and moral standards used by individuals to structure their interactions with other people

Why Do Ethical Rules Develop?

- To slow down or temper the pursuit of self-interest
- To control self-interested behavior by individuals and organizations that threaten the society's collective interests

Why Do Ethical Rules Develop? (cont.)

- Ethical rules reduce transaction costs, that is the costs of monitoring, negotiating, and enforcing agreements between people
  - Reputation effect – Transaction costs:
    - Are higher for organizations with a reputation for illegality
    - Are lower for organizations with a reputation for honest dealings

Why Does Unethical Behavior Occur?

- Personal ethics – Developed as part of the upbringing and education
- Self-interest – Weighing our own personal interests against the effects of our actions on others
- Outside pressure – Pressures from the reward systems, industry, and other forces

Creating an Ethical Organization

- An organization is ethical if its members behave ethically
- Put in place incentives to encourage ethical behavior and punishments to discourage unethical behaviors
- Managers can lead by setting ethical examples
- Managers should communicate the ethical values to all inside and outside stakeholders

Designing an Ethical Structure and Control System

- Design an organizational structure that reduces incentives to act unethically
- Take steps to encourage whistle-blowing – encourage employees to inform about an organization's unethical actions
- Establish position of ethics officer and create ethics committee

Creating an Ethical Culture

- Values, rules, and norms that define an organization's ethical position are part of its culture
- Behaviors of top managers are a strong influence on the corporate culture
- Creation of an ethical corporate culture requires commitment from all levels

Supporting the Interests of Stakeholder Groups

- Find ways to satisfy the needs of various stakeholder groups
- Pressure from outside stakeholders can also promote ethical behavior
- The government and its agencies, industry councils, regulatory bodies, and consumer watchdogs all play critical roles in establishing ethical rules